DOCKET FILE COPY ORIGINAL

RECEIVED

JUN 3 0 2003

Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	WC Docket No. 02-112
	)	
2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	)	CC Docket No. 00-175

COMMENTS OF Z-TEL COMMUNICATIONS, INC.

Thomas M. Koutsky
Z-Tel Communications, Inc.
1200 19th Street, N.W., Suite 500
Washington, DC 20036

Christopher J. Wright
Timothy J. Simeone
HARRIS, WILTSHIRE & GRANNIS LLP
1200 Eighteenth Street, N.W.
Washington, DC 20036
(202) 730-1300

Counsel for Z-Tel Communications, Inc.

June 30, 2003

TABLE OF CONTENTS

Pages

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	))))))))	 WC Docket No. 02-112 CC Docket No. 00-175

COMMENTS OF Z-TEL COMMUNICATIONS, INC.

Z-Tel Communications, Inc. ("Z-Tel") provides these comments in response to the *Further Notice of Proposed Rulemaking* on the "Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements."[1]

INTRODUCTION AND SUMMARY

Section 272(e) – and, in particular, the nondiscrimination and imputation requirements of section 272(e)(4) – articulate important principles that are crucial for developing competition for bundled services. Z-Tel is a small, competitive provider of enhanced, local, and long-distance services to residential and small business customers nationwide, and our chief competitors are, and will remain for the foreseeable future, incumbent LECs, including all Bell Operating Companies. Z-Tel faces the challenge that all new entrants in this industry do: the challenge of having to compete on a retail level with our most important wholesale supplier, the incumbent LEC. It was this challenge that Congress sought to address with the section 272 requirements and other pro-competitive provisions of the Act. The Commission should not be keen to revise

[1] *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, Further Notice of Proposed Rulemaking, ("*Further Notice*"), FCC 03-111 (May 19, 2003).

those Congressionally-mandated provisions until there are robust competitive alternatives to ILEC networks for companies like Z-Tel. Such conditions do not exist today.

In the *Further Notice*, the Commission asked for comment on "whether, and in what manner, the statutory requirements that continue to apply to BOCs under section 272(e) reduce the need for dominant carrier regulations."[2] The answer to that question necessarily depends in part on how the statutory requirements of section 272(e) are construed. In these comments, we focus on section 272(e)(4) and explain that, if construed and enforced properly, section 272(e)(4) would result in a vigorous imputation requirement that would help competition develop for the provision of bundled packages of services. On the other hand, if the nondiscrimination requirement of section 272(e)(4) and other similar provisions of the Telecommunications Act of 1996 are not applied properly, the BOCs will have the opportunity to leverage their dominant position in providing local wholesale and retail services into a dominant position with regard to bundled services.

The Commission should conclude that the requirements of sections 272(e)(2) and (4) do not "sunset." That is the interpretation that best comports with Congressional intent. The most straightforward way to ensure that result is to require BOCs to continue to provide long-distance service through a separate affiliate. In the alternative, the Commission plainly has authority to continue to apply section 272(e)(4) or its equivalent whether or not it requires BOCs to maintain a separate long-distance affiliate, and it ought to do so in order to prevent discrimination that will destroy the competition that is emerging.

[2] *Id.*, ¶ 46.

I. Nondiscriminatory Access To The BOCs' Facilities Is Critical To The Development Of Competitive Telecommunications Markets.

As the Commission recognized in the *Further Notice*, "there has been an increase in offerings of bundled telecommunications services by major interexchange carriers, cable telephony providers, and the BOCs upon section 271 approval."[3] The same is true for many smaller CLECs, including Z-Tel. Z-Tel began as a software company, and it distinguishes itself from other providers of mass-market telecommunications services by offering a sophisticated array of enhanced services – such as voice-mail that may be accessed over the Internet, "find-me" service that forwards calls to multiple numbers, and a variety of voice-activated calling services. Z-Tel provides these Personal Voice Assistant services to its residential customers as part of a package of its telecommunications services.

The critical challenge that Z-Tel and other new entrants face in offering this type of service is the fact that their principal competitor – the incumbent LEC – is also their principal wholesale supplier. As the *Further Notice* recognized, either a BOC or an independent ILEC may "exercise market power through its control of local bottleneck facilities."[4] In addition, "a carrier may be able to unilaterally raise prices by increasing its rivals' costs by restricting its rivals' output through the carrier's control of an essential input, such as access to bottleneck facilities, which its rivals need to offer their services."[5]

The ILECs have both the incentive and the ability to discriminate and engage in price squeezes that threaten to extend their market power from their pervasive local exchange networks into adjacent services. Z-Tel believes that the potential for leverage is not simply into

[3] *Id.*, ¶ 25.

[4] *Id.*, ¶ 29.

[5] *Id.*, ¶ 26

"interstate and international interexchange markets" but also into services that may be bundled with local network access services. As the Commission has concluded in the Triennial Review, competitors seeking to provide "mass-market" service (a term defined by the Commission) may continue to be impaired without access to unbundled loops, transport, switching, and signaling.[6] Those network elements are bottleneck facilities under the control of the incumbent LEC, and entrants like Z-Tel are operationally and economically impaired in providing the local services portion of a bundle without access to those components of the incumbent LEC network. Absent regulation of the price and terms at which those facilities are to be provided by the incumbent LEC to entrants, an ILEC may raise its rivals' costs and hence decrease its rivals' output by raising the prices it charges for those facilities.

Failure to require nondiscriminatory access could result in an anticompetitive price squeeze. Consider a BOC with section 271 authorization that charges $50 per month for a package of services similar to that offered by Z-Tel. It may be that the long-run incremental cost to the BOC of providing the local component of the package is $20, the cost of providing the long-distance component is $15, and the cost of the enhanced service component is $10. If the BOC were permitted to charge an entrant like Z-Tel $30 per month to lease the local network (50% higher than the BOC's incremental cost), then a company like Z-Tel is squeezed – it would not be able to compete against the BOC because its network access costs would be significantly higher.

It is clear that competition will not develop if the incumbents' incremental cost of using their bottleneck facilities is less than what it charges for access to competitors. The Antitrust

[6] *FCC Adopts New Rules For Network Unbundling Obligations Of Incumbent Local Phone Carriers*, Press Release (Feb. 20, 2003), attachment at 1 (loops, switching, signaling), 3 (transport).

Division of the Department of Justice made that point clearly and concisely in its May 1996 comments urging the Commission to adopt a forward-looking pricing regime:

> Pricing above forward looking economic costs also would subject competitors to substantial risks of a "price squeeze." In competing against entrants to sell services to end users, the real cost of an input (i.e., a network element) for the ILEC will be its forward looking economic cost, and it can set its prices to the consumer accordingly. But for the entrant against whom the ILEC competes, the cost of the elements will be the price charged for it by the ILEC. If this price is above economic cost, the entrant is placed at an artificial competitive disadvantage arising from its dependence on, and the ILEC's exploitation of, the incumbent's market power. If the difference between the element's price and its true cost is sufficiently large, the ILEC could engineer a "price squeeze" that could be fatal to the entrant's ability to compete.[7]

The Commission endorsed the Antitrust Division's views.[8]

Shortly after the Eighth Circuit invalidated TELRIC (and before the Supreme Court approved TELRIC), five former chief economists of the Antitrust Division – four who served in Republican administrations and one who served in a Democratic administration – urged the FCC "to stand by the Commission's original decision," noting that "there is a large body of intellectual capital behind that decision."[9] The former chief economists specifically stated that competitive efficiency would not be promoted if "competitive providers . . . have to pay more than the incumbents local exchange carriers have to pay for these same inputs."[10] As the former

---

[7] Comments of the United States Department of Justice, CC Docket 96-98 (May 16, 1996), at 31.

[8] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 (1996) ("*First Report and Order*"), ¶ 635 (summarizing the Antitrust Division's views), ¶ 679 (adopting a methodology designed to establish prices for network elements "based on costs similar to those incurred by the incumbents").

[9] Letter from Bruce Owen *et al.* to Hon. Reed E. Hundt, CC Docket 96-98 (Dec. 2, 1996), at 2.

[10] *Id.* The former chief economists added: "The incumbent local exchange carriers complain that if the prices for unbundled elements and interconnection are based on TELRIC, they will be unable to recover full costs and thus unable to make new investments. The opposite is true." *Id.* They explained that by permitting the ILECs to recover their forward-looking costs, including

chief economists stated, it is critical that competitive carriers are able to obtain access to the ILECs' facilities on a nondiscriminatory basis.

II. Section 272(e)(4) Prohibits Discriminatory Access To BOC Facilities And Requires The BOCs To Impute Appropriate Costs In Pricing Their Services.

Section 272(e)(4) states that "a BOC may provide any interLATA or intraLATA facilities to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, so long as the costs are appropriately allocated." Like many other of the market-opening provisions of the 1996 Act, section 272(e)(4) is principally a nondiscrimination rule, as the Commission concluded in a 1997 Order focusing entirely on section 272(e)(4) (the "*Section 272(e)(4) Order*").[11]

Section 272(e)(4)'s requirement that a BOC provide its facilities and services to competitors "so long as the costs are appropriately allocated" indicates that rates for BOC retail services must pass an imputation test, to ensure that the BOC does not discriminate against entrants like Z-Tel. With respect to the example given above, under section 272(e)(4) the BOC would not be permitted to charge $30 to lease the facilities comprising the local network platform if it imputed only $20 per month for the local network services to its retail service. Properly interpreted, this imputation requirement gives the Commission the power – and the obligation – to investigate Bell company pricing and terms for bundled services.

---

the cost of capital, the Commission had preserved their incentive to invest, while an historic cost pricing regime would result in inefficiencies that would distort incentives. *Id.*

[11] *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended*, Second Order on Reconsideration, 12 FCC Rcd 8653 (1997), ¶ 55. The BOCs had argued that section 272(e)(4) was not a "local competition" provision but instead "an affirmative grant of authority to provide integrated interLATA services on a wholesale basis." *Id.* The Commission properly rejected this interpretation. As the Commission stated, acceptance of the BOCs' interpretation of section 272(e)(4) would logically have permitted the BOCs to provide retail long-distance service without obtaining authorization under section 271. *Id.*, ¶ 39. Like the Commission, the D.C. Circuit rejected the BOCs' contentions in *Bell Atlantic v. FCC*, 131 F.3d 1044 (1997).

In passing the 1996 Act, Congress clearly cared very much about the principle of nondiscrimination, and section 272(e)(4) is one of a number of nondiscrimination requirements that were enacted in 1996. Section 251(c)(3) similarly (and doubly) proscribes discrimination: it requires all ILECs to provide "nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory." Section 271(c)(2)(B)(ii) also requires BOCs to provide "Nondiscriminatory access to network elements" and cross-references section 251(c)(3) and its pair of nondiscrimination requirements. Section 272(e)(4) adds to this requirement because it discusses directly the impact nondiscrimination would have on BOC retail pricing and practices: the provision specifically notes its requirement that wholesale rates be "properly allocated" to BOC retail services, a requirement not explicitly mentioned in the other nondiscrimination provisions.

Imputation principles would help ensure that Bell company bundles not create a price squeeze for new entrants like Z-Tel. Preventing the potential for leveraging was Congress's intent in passing the local competition provisions of the Act and should be maintained. Like the golden rule, section 272(e)(4) squarely requires BOCs to treat competitors the same as they treat themselves. This provision thus ensures that the BOCs cannot engage in price squeezes that would permit the BOCs to prevent competition from developing in local markets and to extend their dominance to other markets.

III. The Commission Should Not Allow Section 272(e)(4)'s Prohibition On Discriminatory Access To BOC Facilities To Sunset.

As the *Further Notice* stated, the Commission previously concluded that the requirements of section 272(e)(4) sunset three years after a BOC obtains authorization under section 271 unless the Commission decides to extend its requirements.[12] That is not the best reading of the statute. Section 272(f)(1) indicates that Congress intended all of the requirements of section 272(e) to continue in effect, regardless of the automatic sunset requirement. Section 272(f)(1) provides that the requirements of section 272 "other than subsection (e)" automatically sunset "unless the Commission extends the 3-year period by rule or order." The Commission must give full meaning to that parenthetical in section 271(f)(1) – the provisions excepting section 272(e) from sunset. That provision makes clear that Congress did not intend the nondiscrimination requirements of section 272(e) to sunset. It is not surprising that Congress would have nondiscrimination obligations continue in effect, as they are a core feature of the 1996 Act and necessary to the development of competition.

The approach the Commission adopted previously does not give meaning to each of the various statutory provisions. In particular, granting a BOC a method of essentially "opting out" of the nondiscrimination and imputation requirements of section 272(e)(4) (by folding its affiliate) would run counter to the purpose of those provisions, which is to protect competitors from competitive issues that arise when their wholesale supplier is also their retail competitor. The Commission's interpretation of section 272(e)(4) would, in fact, give the BOCs the opportunity to effectively "sunset" the nondiscrimination and imputation strictures of section 272(e)(4), despite Congress's clear statement to the contrary in section 271(f)(1).

[12] *Further Notice*, ¶ 45 & n. 100.

The best solution to this issue is simply to extend the applicability of section 272(e)(4). There is no question that the Commission may do so, since section 272(f)(1) expressly contemplates extension, and there is every reason to extend the applicability of section 272(e)(4). As explained above, it plainly (if at least somewhat redundantly) prohibits the sort of discriminatory behavior that would lead to a price squeeze that could extend the BOCs' monopolies into the market for packages of telephone services. It simply cannot be argued that the extension of the BOCs' monopolies is a desirable result. To the contrary, the entire thrust of section 271 *et seq.* is to prevent the BOCs from leveraging their dominance in local markets into adjacent markets. Accordingly, the Commission should conclude that the nondiscrimination requirement of section 272(e)(4) should continue in effect. The most straightforward way to do that would be to require the BOCs to continue to use a separate affiliate to provide long-distance.

But the Commission could maintain these obligations without regard to BOC corporate structure. Since section 272(f)(3) makes clear that nothing in the section limits the Commission's authority under other provisions of the Communications Act, the Commission could use its long-standing authority under sections 201 and 202 to require BOCs (and other ILECs) to provide nondiscriminatory access to their facilities, even if it decides not to require the BOCs to use a separate affiliate. Those provisions require rates for interstate communications to be just, reasonable, and nondiscriminatory, just as section 252(d)(1), the statutory basis for TELRIC, requires rates for network elements to be just, reasonable, and nondiscriminatory. Under sections 201 and 202, unlike section 252(d)(1), the Commission is not *required* to establish cost-based rates, but the D.C. Circuit has held that the Commission must "specially justify" departures from cost-based pricing.[13] Accordingly, under Commission precedent there is

[13] *CompTel v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996).

authority to establish forward-looking cost-based – and hence nondiscriminatory – rates under sections 201 and 202. Indeed, under D.C. Circuit precedent following any other path would subject the Commission to stricter scrutiny.[14]

CONCLUSION

The provisions of section 272(e) are important to ensuring nondiscrimination, *especially* when a Bell company seeks to offer "bundled" service packages. The growing trend towards "bundled" packages (which include more than simply local and long-distance services) *increases* the need for strong anti-discrimination regulations and enforcement.

It is clear the incumbent LECs (including the BOCs) own pervasive local networks that new entrants like Z-Tel cannot reasonably duplicate, especially for "mass-market" consumers (as defined in the FCC's Triennial Review Order). For a company like Z-Tel to sell its enhanced and bundled services, it has no choice but to deal on a wholesale basis with its principal retail competitor – the incumbent LEC. Ownership of these bottleneck facilities puts incumbent LECs in a *dominant* position, and dominant carrier regulation should remain.

The nondiscrimination and imputation provisions of section 272(e) should be maintained and strongly enforced. In particular, section 272(e)(4) requires the BOCs to provide their facilities to competitors at the same rates and on the same terms and conditions that they provide those facilities to themselves. That provision, like other overlapping nondiscrimination

---

[14] The Commission has concluded that sections 201 and 202 govern the leasing of network elements required to be unbundled under section 271 but not section 251. *FCC Adopts New Rules For Network Unbundling Obligations Of Incumbent Local Phone Carriers*, Press Release (Feb. 20, 2003), attachment at 4. In our view, section 252(d)(1) establishes the appropriate pricing standard for network elements and the Commission lacks authority to establish prices under sections 201 and 202 beyond the portion of facilities used to provide interstate service. If our view is correct, the pricing standard of section 252(d)(1) applies and will result in nondiscriminatory cost-based rates. But if the Commission's view is a permissible reading of the statute, then sections 201 and 202 should be construed to call for nondiscriminatory cost-based rates.

provisions, prevents price squeezes and therefore protects the development of competitive telecommunications markets. The Commission should remain faithful to Congressional intent and ensure that *all* of the nondiscrimination requirements of section 272(e) remain in place. Enforcing these nondiscrimination and imputation requirements will ensure that the 1996 Act serves to open all markets to competition rather than permitting the incumbents to extend their dominant position of owning pervasive local telephone networks into the provision of other, adjacent services. That is clearly what Congress intended to accomplish.

Respectfully submitted,

By: ________________
Christopher J. Wright
Timothy Simeone
HARRIS, WILTSHIRE & GRANNIS LLP
1200 Eighteenth Street, N.W.
Washington, DC 20036
(202) 730-1300

Counsel for Z-Tel Communications, Inc.

Thomas M. Koutsky
Z-Tel Communications, Inc.
1200 19th Street, N.W. Suite 500
Washington, DC 20036

June 30, 2003